US Embassy Jakarta
ECONOMIC SECTION

INDONESIA: MINISTRY OF FINANCE AND BANK INDONESIA LAUNCH REFORM EFFORTS

Summary:

- On December 27, 2006, Minister of Finance Sri Mulyani Indrawati officially launched a new organizational structure for the Directorate General for Tax (DGT) that reduces the operational role of the DGT headquarters in Jakarta, divides the DGT headquarters into functional Directorates, and establishes formal work units to lead the further modernization of the DGT.
- Two days later, the Minister signed a new decree outlining parameters for a Primary Dealer system for government bond auctions.
- The Ministry of Finance (MOF) is currently accepting applications for Primary Dealers with the first auctions to take place in March.
- The MOF will also issue Indonesia's first T-bills on April 3, July 10 and December 4, 2007 and will again issue the popular "retail bonds" launched in 2006.
- At Bank Indonesia's (BI) annual policy speech event on January 12, BI Governor Burhanuddin Abdullah announced several policy initiatives for 2007 to help support economic growth, and encourage lending to the real sector.
- BI also plans to issue bank guidelines limiting foreign manpower at the middle-management level and requiring a "transfer of knowledge" to domestic employees within three years.
- This report uses an exchange rate of Rp 9,115 to the dollar.

Tax Administration Reform Picks Up Speed

On December 27, 2006, Minister of Finance Sri Mulyani Indrawati officially launched a new organizational structure for the DGT that reduces the operational role of the DGT headquarters in Jakarta, divides the DGT headquarters into functional Directorates, and establishes formal work units to lead the modernization of the DGT. The new structure dissolves separate Directorates that formally administered all aspects of Indonesia's income, value-added (VAT), and land and building taxes from taxpayer relations to audits, and replaces them with units that perform a specified function for all tax types. This reform reduces duplication of multiple investigative units for each tax type. In addition, for the first time, the DGT will have dedicated, full-time staff to lead Indonesia's ambitious tax modernization program. Tax authorities mainly concentrate tax modernization efforts in the new directorates of "Internal Compliance and Organizational Transformation;" "Communication and Technology Transformation;" and "Business Process Transformation." Under the new structure, DGT headquarters will function as a policy-making body that also provides back office support to local tax offices, which will have the main operational tasks.

Directorate General for Tax:
Old vs New Structure

Previous Directorates/Units	New Direcotrates/Units
Secretary General	Secretary General
Taxation System and Potential Planning	Potential, Compliance, and Collection
Tax Regulation	Tax Regulation I
---	Tax Regulation II
Tax Audit, Collection, and Investigation	Audit and Collection
---	Intelligence and Investigation
Tax Information	Tax Information Technology
Tax Dissemination	Tax Dissemination, Service, and PR
Income Tax	---
VAT and Electricity Tax	---
Land & Building Tax, and Land & Building Acquisition Tax	---
---	Tax Extensification and Appraisal
---	Tax Objection and Appeal
---	Internal Compliance and Resources Transformation
---	Information & Communication Technology Transformation
---	Business Process Transformation
Regional Offices	Regional Offices
---	Data Processing Center

Source: Directorate General for Tax

On December 29, 2006, Minister Mulyani also swore in 81 new Echelon II (director level) officials at the MOF, 44 of whom work at DGT. The DGT also officially opened 13 “Medium Tax Offices” (MTOs) in Jakarta and eight other large cities in December 2006 which will start operations in April 2007. Like Indonesia’s Large Tax Offices (LTOs), which have provided improved service to the country’s largest corporate taxpayers since 2002, the MTOs aim to provide better and faster services, simplify tax compliance and optimize tax audits through online tax filing. The tax audit process will include a closing conference with the taxpayer, at which the taxpayer can submit any objections.

Foreign and domestic investors and businesses welcome the tax reform: lack of transparency in the tax office had been a frequent source of complaints. A number of donors, including International Monetary Fund (IMF), the Australian Agency for International Development (AUSAID), USAID, World Bank, the Japan International Cooperation Agency (JICA), Australian Taxation Office (ATO), and Swedish Tax Administration (under SIDA), are providing DGT with technical assistance on a range of tax administration reform issues, including tax return management, audit, database development, internal compliance and human resource development.

New MOF Regulation on Primary Dealer System

On December 29, 2006 Finance Minister Sri Mulyani Indrawati signed Ministerial Decree No. 144/2006 establishing a Primary Dealer System for rupiah-denominated government securities. The decree outlines the requirements, rights, and obligations for financial institutions (banks and securities firms) that wish to serve as MOF-appointed primary dealers. The decree obligates the primary dealers to report regularly to the Director General for Debt Management, and sets out procedures relating to price quotations. The MOF began accepting applications for primary dealers on February 2 and plans to organize the first auctions under the new system in March 2007. Indonesia's existing Inter-Dealer Market Association's 24 members (14 domestic banks, six foreign banks, and four securities companies) had previously acted as a de facto primary dealers market.

The decree specifies a facility under which the MOF could lend government securities to primary dealers if the demand for bonds in the secondary market is heavy. Under the facility, primary dealers can borrow government bonds from the MOF by submitting a guarantee worth 1.2 times the value of the bonds. The MOF will impose a weighted average interest rate of the inter-bank overnight rate plus two percent. Primary dealers can also obtain loans from BI in the case of excessive sales or bond market volatility by putting up bonds as a guarantee.

Indonesia Announces First T-Bills

The MOF announced on January 22 a schedule for the first ever issuance of short-term Treasury Bills (T-bills) in Indonesia. Director General for Debt Management Rahmat Waluyanto said the proceeds from the T-bill issuances will help finance the state budget deficit, expected to be 1.1% of GDP in 2007. BI officials stated the issuance will probably not exceed Rp 7.5 trillion ($823 million) in 2007. According to Waluyanto, the MOF will issue the T-bills on April 3, July 10 and December 4, 2007. The Ministry also plans to issue popular retail treasury bonds in March, June and November 2007. The MOF issued Rp 3.3 trillion ($364 million) in retail bonds in July 2006, which proved popular with investors. Waluyanto also said that the MOF has tentatively scheduled Indonesia's first sharia bond issuance for September 2007, pending approval of related legislation by lawmakers. Legislation to facilitate sharia bond issuance has been pending in Parliament since at least early 2005.

BI Relaxes Bank Lending Regulations

During his annual policy speech on January 12, BI Governor Burhanuddin Abdullah described several new policy initiatives for 2007 aimed at stimulating bank lending and economic growth in the wake of high-interest rates and slow loan growth in 2006. BI Governors traditionally use the annual speech to announce policy priorities and initiatives, allowing banks time to provide feedback before BI issues implementing regulations. Analysts particularly focused on initiatives relating to the bank intermediation function, guidelines to evaluate credit collectibility and prudential principles.

During a press briefing prior to the speech, BI Deputy Governor Muliaman Hadad explained that BI designed the lending stimulus package to reduce loan provisioning by domestic banks in order to free up capital that they could then steer to private sector lending. In order to implement the policy package, BI intends to relax the asset quality classification regulation No 8/2/PBI/2006 from January 2006, which followed on a regulation first issued in January 2005. The introduction of the regulation in January 2005 led several state banks to significantly raise the amount of their non-performing loans (NPLs) in the first half of 2005 (state-owned Bank Mandiri's NPLs rose from 7% to 25% at that time). BI plans to issue detailed regulations later in 2007 to implement the package.

According to Hadad, BI intends to make the following changes to BI's credit collectibility guidelines and prudential regulations to encourage lending:

- Adding machinery and inventory (warehouse receipts) to the types of collateral that banks can use to secure loans and reduce the provisioning levels for NPLs. This initiative aims at boosting lending to small-and-medium enterprises (SMEs), which are often unable to meet current loan collateral standards.

- Confirming a previous regulation allowing banks to lend an amount up to 30% of their capital to state-owned enterprises (SOEs) operating in the infrastructure sector. In addition, BI plans to expand the coverage of the regulation to allow lending up to the same level to SOEs operating in "other sectors".

- Clarifying the definition of "related parties" under Indonesia's Maximum Credit Allocation Limit to permit more liberal lending to jointly-financed projects. BI plans to issue implementing regulations to set forth the new rules.

- Reiterating that it is possible to provide new loans to problem borrowers providing: a) the borrowers ""maintain good intentions" to repay and; b) the loan is distressed for reasons beyond the borrower's control.

- Raising the ceiling for loans subject to "timely repayment" criteria from Rp 500 million ($55,000) to Rp 5 billion ($550,000). Currently, banks must consider three parameters when considering loans over Rp 500 million ($55,000): business prospects of the borrower, debtor performance, and promptness of payment. BI intends to revise current regulations to drop the requirement that banks evaluate the business prospects and performance of debtors for loans to micro enterprises and SMEs. In addition, BI intends to grant exceptions to the three parameters for specific project-related loans that have government guarantees and are a high priority for the government. Banks still must consider business prospects and performance in classifying loans above Rp 5 billion ($550,000). Currently, 54%

> of domestic banking sector lending is for individual loans of less than Rp 5 billion ($550,000), according to Hadad.

Abdullah also announced that BI intends to further restrict the number of expatriates employed in banks in Indonesia. For foreign banks, BI will limit the expatriate personnel to two levels below the board of directors, except for specialized functions local employees cannot fill. For specialized functions, BI plans to give foreign banks three years to train and "transfer knowledge," gradually replacing expat workers with local staff.

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